

149 FERC ¶ 61,056
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Cheryl A. LaFleur, Chairman;
Philip D. Moeller, Tony Clark,
and Norman C. Bay.

Tucson Electric Power Company
UNS Electric, Inc.
Gila River Power LLC

Docket No. EC14-88-000

ORDER AUTHORIZING ACQUISITION AND DISPOSITION OF JURISDICTIONAL
FACILITIES

(Issued October 20, 2014)

1. On May 15, 2014, Tucson Electric Power Company (Tucson Electric), UNS Electric, Inc. (UNS Electric) (together, Buyers), and Gila River Power LLC (Gila River) (collectively, Applicants) filed an application pursuant to section 203 of the Federal Power Act (FPA)¹ and Part 33 of the Commission's regulations² requesting authorization under FPA section 203(a)(1) for Buyers to acquire jointly all assets constituting one of the four 550 megawatt (MW) power blocks (Power Block 3) of the Gila River Power Station (Gila River Station),³ as well as a 25 percent undivided co-ownership interest in the common assets of the Gila River Station, including associated interconnection

¹ 16 U.S.C. § 824b (2012).

² 18 C.F.R. pt. 33 (2014).

³ The Gila River Station is a natural gas-fired generating facility located in Maricopa County, Arizona with a total installed capacity of approximately 2,200 MW. Buyers propose to acquire Power Block 3 of the Gila River Station. *See* Application for Approval Pursuant to Section 203 of the Federal Power Act and Request for Expedited Consideration at 1, 5, Docket No. EC14-88-000 (May 15, 2014) (Application).

facilities, and certain other assets (the Proposed Transaction).⁴ We grant the requested authorization, as discussed below.

I. Background

A. Description of Applicants

1. Tucson Electric and UNS Electric

2. Applicants explain that Buyers are both wholly-owned subsidiaries of UNS Energy Corporation (UNS Energy) and are both subject to regulation by the Arizona Corporation Commission.⁵

3. Applicants state that Tucson Electric is a vertically-integrated utility that provides regulated electric service to retail customers and sells electricity at wholesale to other utilities and power marketers in the southwestern United States.⁶ Applicants note that Tucson Electric owns or leases nearly 2,500 MW of generating capacity and owns certain electric transmission facilities that are used primarily to transmit power generated at several generating stations to Tucson Electric's service territory for use by its customers. Tucson Electric also owns, or participates in, an overhead electric transmission system consisting of approximately 2,005 circuit-miles of high voltage lines.⁷ Access to these transmission facilities is provided pursuant to Tucson Electric's Open Access Transmission Tariff (OATT). Applicants state that Tucson Electric operates a North American Electric Reliability Corporation (NERC) certified Balancing Authority Area

⁴ Power Block 3 and the 25 percent undivided co-ownership interest in the common assets of the Gila River Station are referred to in this order as the Proposed Transaction Assets.

⁵ Applicants note that in April 2014, a wholly-owned subsidiary of Fortis Inc. (Fortis) was authorized, by delegated authority, to acquire all of the interests in UNS Energy (Fortis Transaction). *See Fortis Inc.*, 147 FERC ¶ 62,004 (2014) (April 2014 Order). Applicants state that the Fortis Transaction, which was expected to close by the end of 2014, has no bearing on the Application or the Proposed Transaction because there is no geographic overlap between the electric or gas assets owned by Fortis and its affiliates, and the assets owned by UNS Energy and its affiliates. Application at 2, n.5. The Commission was notified that the Fortis Transaction was consummated on August 15, 2014. *See Notice of Consummation*, Docket No. EC14-56-000 (Aug. 21, 2014).

⁶ Application at 2.

⁷ *Id.* at 3.

within Arizona and portions of western New Mexico, and that the Commission has granted Tucson Electric market-based rate authority. Applicants note that Tucson Electric does not provide any wholesale or retail natural gas service, nor does it own or operate any natural gas pipelines or distribution facilities.

4. Applicants explain that UNS Electric provides retail electric service to residential and commercial customers in northwestern and southeastern Arizona.⁸ According to Applicants, UNS Electric owns generating facilities with a combined rating of approximately 230 MW, and has been granted market-based rate authority by the Commission. UNS Electric's transmission system consists of approximately 334 circuit-miles of transmission lines rated 69 kV and above, and access to these facilities is provided pursuant to UNS Electric's OATT.

5. Applicants explain that UNS Electric does not operate its own electric Balancing Authority Area; rather, its transmission lines and load are part of the Tucson Electric Balancing Authority Area.⁹ Applicants state that, historically, UNS Electric's lines and load were not contiguous to the "core" of the Tucson Electric Balancing Authority Area. Instead of being directly interconnected to the Tucson Electric service territory, UNS Electric's lines and loads were interconnected with third-party transmission lines that form part of the adjacent Western Area Power Administration-Lower Colorado Balancing Authority Area. In December 2013, however, with the energizing of the Vail-Valencia transmission line, the UNS Electric service territory in Santa Cruz County in southern Arizona became directly interconnected with the core of the Tucson Electric Balancing Authority Area. Applicants note, however, that UNS Electric's transmission system in Mohave County in northwestern Arizona is still not directly interconnected with Tucson Electric's system and remains interconnected with the Tucson Electric Balancing Authority Area only over third-party transmission lines.¹⁰

2. Gila River

6. According to Applicants, Gila River is an indirect, wholly-owned subsidiary of Entegra Power Group (Entegra). Gila River is a public utility that has been authorized by the Commission to make sales of electric energy, capacity, and ancillary services at market-based rates. It owns and operates a portion of the Gila River Station, which is interconnected with the transmission system owned and operated by Arizona Public Service Company. Applicants note that the Gila River Station is located in the Gila River

⁸ *Id.* at 4.

⁹ *Id.*

¹⁰ *Id.*

Maricopa Balancing Authority Area, in which it is the only generating capacity and in which there is no load. Applicants state that for market power analysis purposes, the Commission has established the Arizona Public Service Company Balancing Authority Area as the relevant market area for the Gila River Station.¹¹

7. Applicants explain that, since June 2007, Gila River has made long-term sales to Arizona Public Service Company pursuant to a unit contingent power purchase and sale agreement for the output of one of the four power blocks at the Gila River Station. Applicants note that Gila River has no rights to the power dedicated to Arizona Public Service Company under that agreement, which extends to 2017.

8. Applicants also explain that, pursuant to two separate, Commission-approved transactions that closed in 2010 and 2011, Gila River transferred to Sundevil Power Holdings, LLC (Sundevil), an unaffiliated third party, two of the four power blocks at the Gila River Station. Sundevil markets the energy, capacity, and ancillary services from the power blocks that it owns independently from Gila River's sales from the power blocks it has retained.

9. Applicants state that, as a result of the dedication of one of the power blocks at the Gila River Station to the Arizona Public Service Company power purchase agreement and the sale of two of the power blocks of the Gila River Station to Sundevil, Gila River exercises control over only one of the four power blocks at the Gila River Station – Power Block 3 – which Buyers propose to purchase as part of the Proposed Transaction.¹²

B. The Proposed Transaction

10. According to Applicants, the Proposed Transaction provides the opportunity for Buyers to “rebalance” their generation portfolios towards natural gas-fired resources. Applicants state that Tucson Electric currently owns 14.1 percent of Springerville Unit 1, a 387 MW coal-fired generating unit, and leases the remaining capacity of that unit pursuant to several leases which will expire by their terms on January 1, 2015 (the Springerville Leases). Pursuant to its rights under those leases, Tucson Electric has decided to purchase an additional 35.4 percent ownership interest in Springerville Unit 1 on or before the time the Springerville Leases expire. After purchasing the additional

¹¹ *Id.* at 6, n.17 (citing Updated Market Power Analysis for Continued Market-Based Rate Authority – Southwest Region, Docket No. ER11-4315-002 (Jun. 28, 2013)). The updated market power analysis referred to by Applicants was accepted via delegated letter order on May 23, 2014.

¹² *Id.* at 5-6.

ownership interest, Tucson Electric will own a 49.5 percent interest in Springerville Unit 1, but will no longer hold any leases for the remaining capacity of Springerville Unit 1. As a result of the expirations of the Springerville Leases and Tucson Electric's purchase of the additional 35.4 percent interest in Springerville Unit 1 (referred to together as the Springerville Transactions), Tucson Electric's net generating capacity at the Springerville facility will decrease by 195 MW.

11. To replace the net capacity lost at Springerville Unit 1, Buyers have entered into an agreement with Gila River to acquire the Proposed Transaction Assets, i.e. Power Block 3 and the 25 percent undivided co-ownership interest in the common assets of the Gila River Station. Buyers intend to use their shares of Power Block 3 to serve their respective load obligations.

12. Although Applicants state that Tucson Electric intends to acquire a 75 percent interest in the Proposed Transaction Assets and UNS Electric intends to acquire a 25 percent interest, they note that the actual split of the interests will not be determined until closer to the closing of the Proposed Transaction. Accordingly, Applicants request authorization (1) for Tucson Electric to acquire between a 75 and 100 percent interest in the Proposed Transaction Assets, and (2) for UNS Electric to acquire the balance of the Proposed Transaction Assets not acquired by Tucson Electric.¹³ Buyers commit to notify the Commission of the actual, as-consummated split in their post-closing notice of consummation submitted to the Commission.

13. Applicants explain that they anticipate closing the Proposed Transaction in December 2014. As explained above, however, the Springerville Transactions, which will occur on or before January 1, 2015, will have an impact on the amount of generation owned or controlled by Buyers. Specifically, if the Proposed Transaction closes prior to December 14, 2014, Buyers' net generating capability will increase by 550 MW (the capacity of Power Block 3). However, as of January 1, 2015, the increase in net generating capability due to the purchase of Power Block 3 will be mitigated by the expiration of the Springerville Leases, resulting in a net increase of 355 MW (the 550 MW increase in capability due to the purchase of Power Block 3 minus the 195 decrease in generating capability due to the Springerville Transactions).

14. Applicants state that, in the event the Proposed Transaction closes prior to December 31, 2014, there will be a short period of time, between the closing date of the Proposed Transaction and December 31, 2014 (the Interim Period), during which the generation owned and controlled by Buyers will increase by the full 550 MW of Power Block 3. In order to mitigate any concerns the Commission may have regarding horizontal market power during the Interim Period, Tucson Electric commits to enter into

¹³ *Id.* at 8.

a tolling arrangement with Gila River pursuant to which Gila River will continue to control 200 MW of Power Block 3 during the Interim Period (Interim Tolling Agreement). Applicants explain that, as mitigated by the Interim Tolling Agreement, the Proposed Transaction will result in an increase in generating capacity controlled by Buyers of only 350 MW during the Interim Period, and that after January 1, 2015, the Proposed Transaction will result in an increase in generating capacity controlled by Buyers of no more than 355 MW.

II. Notice of Filings

15. Notice of the Application was published in the *Federal Register*, 79 Fed. Reg. 30,116 (2014), with interventions and protests due on or before June 16, 2014. In a May 19, 2014 errata notice, the comment date was extended to July 14, 2014. None were filed.

16. On July 24, 2014, the Director of the Division of Electric Power Regulation - West issued a request for additional information from Applicants.¹⁴ Applicants filed a response to the request on August 14, 2014.¹⁵ Notice of Applicants' response to the Request for Additional Information was published in the *Federal Register*, 79 Fed. Reg. 50,640 (2014), with interventions and protests due on or before September 4, 2014. None were filed.

III. Discussion

A. Standard of Review under FPA Section 203

17. FPA section 203(a)(4) requires the Commission to approve a transaction if it determines that the transaction will be consistent with the public interest.¹⁶ The Commission's analysis of whether a transaction will be consistent with the public interest generally involves consideration of three factors: (1) the effect on competition; (2) the

¹⁴ Request for Additional Information, Docket No. EC14-88-000 (July 24, 2014) (Request for Additional Information).

¹⁵ Response to Request for Additional Information and Request for Shortened Notice Period, Docket No. EC14-88-000 (Aug. 14, 2014) (Applicants Response to Information Request).

¹⁶ 16 U.S.C. § 824b(a)(4) (2012).

effect on rates; and (3) the effect on regulation.¹⁷ FPA section 203(a)(4) also requires the Commission to find that the transaction “will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless the Commission determines that the cross-subsidization, pledge, or encumbrance will be consistent with the public interest.”¹⁸ The Commission’s regulations establish verification and information requirements for applicants that seek a determination that a transaction will not result in inappropriate cross-subsidization or a pledge or encumbrance of utility assets.¹⁹

B. Analysis of the Proposed Transaction

18. Applicants argue that the Proposed Transaction will have no adverse effect on competition, rates, or regulation and is therefore consistent with the public interest. Applicants also claim that the Proposed Transaction will not result in cross-subsidization of a non-utility associate company, or a pledge or encumbrance of utility assets for the benefit of an associate company, and conclude that the Proposed Transaction should be approved without conditions.²⁰

19. In their response to the Request for Additional Information, Applicants provided answers to questions related to the Simultaneous Import Transmission Limit (SIL) study and the Delivered Price Test model they provided in the Application.²¹ Applicants

¹⁷ See *Inquiry Concerning the Commission’s Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, FERC Stats. & Regs. ¶ 31,044, at 30,111 (1996), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997) (Merger Policy Statement). See also *FPA Section 203 Supplemental Policy Statement*, FERC Stats. & Regs. ¶ 31,253 (2007) (Supplemental Policy Statement). See also *Revised Filing Requirements Under Part 33 of the Commission’s Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111 (2000), *order on reh’g*, Order No. 642-A, 94 FERC ¶ 61,289 (2001). See also *Transactions Subject to FPA Section 203*, Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005), *order on reh’g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh’g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006).

¹⁸ 16 U.S.C. § 824b(a)(4) (2012).

¹⁹ 18 C.F.R. § 33.2(j) (2014).

²⁰ Application at 11.

²¹ As required by the Commission’s regulations, Applicants performed a Competitive Analysis Screen, also referred to as a Delivered Price Test, to determine the pre- and post-transaction market shares from which the market concentration or Herfindahl-Hirschman Index (HHI) change can be derived. The HHI is a widely
(continued ...)

conclude that, even under the alternative assumptions and approaches analyzed in their response to the Request for Additional Information, the Proposed Transaction does not raise any competitive concerns under the Commission's guidelines.²²

1. Effect on Competition

a. Overview of Applicants' Analysis

20. Applicants state that Power Block 3 is currently part of the Gila River Maricopa Balancing Authority Area, a generation-only Balancing Authority Area. Applicants assert, however, that the Commission has established that the Gila River Station should be modeled as being in the Arizona Public Service Company Balancing Authority Area for purposes of analyzing market power in the context of market-based rate authority analyses. According to Applicants, the same reasons that compelled the Commission to find that the Gila River Station should be modeled as being in the Arizona Public Service Company Balancing Authority Area for market-based rate authority purposes support

accepted measure of market concentration, calculated by squaring the market share of each firm competing in the market and summing the results. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases. Markets in which the HHI is less than 1,000 points are considered to be unconcentrated; markets in which the HHI is greater than or equal to 1,000 but less than 1,800 points are considered to be moderately concentrated; markets in which the HHI is greater than or equal to 1,800 points are considered to be highly concentrated. In the Merger Policy Statement, the Commission adopted the 1992 Federal Trade Commission (FTC)/Department of Justice (DOJ) Horizontal Merger Guidelines, which state that in a horizontal merger, an increase of more than 50 HHI points in a highly concentrated market or an increase of 100 HHI points in a moderately concentrated market fails the relevant screen and warrants further review. U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, 57 Fed. Reg. 41,552 (1992), revised, 4 Trade Reg. Rep (CCH) ¶ 13,104 (April 8, 1997). On August 19, 2010, the FTC and DOJ issued revised horizontal merger guidelines, which, among other things, raised the thresholds for the measures of market concentration. The Commission continues to base its analysis on the thresholds adopted in the 1992 FTC/DOJ guidelines, as currently implemented by the Commission. See *Analysis of Horizontal Market Power Under the Federal Power Act*, FERC Stats. & Regs. ¶ 35,571 (cross-referenced at 134 FERC ¶ 61,191 (2011)), *order reaffirming Commission Policy*, 138 FERC ¶ 61,109 (2012).

²² Applicants Response to Information Request, Exhibit A: Arenchild Affidavit at 2 (Supplemental Arenchild Aff.).

modeling Power Block 3 in the Arizona Public Service Company Balancing Authority Area for purposes of the Competitive Analysis Screens submitted with the Application.²³

21. Applicants also explain that Buyers will be using firm point-to-point transmission to move the energy generated by Power Block 3 to Tucson Electric's load in its Balancing Authority Area, and to UNS Electric's load in its Mohave County service territory (which, as explained above, is not directly connected to the Tucson Electric Balancing Authority Area, but is directly connected to the Western Area Power Administration-Lower Colorado Balancing Authority Area).²⁴

22. Applicants state that they based their analyses on conservative assumptions. For purposes of their analysis of the Tucson Electric Balancing Authority Area, Applicants state that they conservatively assumed that Tucson Electric would own 100 percent, of Power Block 3; for purposes of Applicants' analysis of the Western Area Power Administration-Lower Colorado Balancing Authority Area, Applicants state that they conservatively assumed that UNS Electric would own 25 percent of Power Block 3, and that Tucson Electric would own 75 percent.

i. Horizontal Competition in Generation

23. According to Applicants, their analysis shows that, due to the Springerville Transactions, and as mitigated by the Interim Tolling Agreement described above, the Proposed Transaction does not raise market power concerns. Specifically, Applicants state that their analysis shows that, under the Available Economic Capacity measure,²⁵ assuming that Tucson Electric would own a 100 percent interest in Power Block 3, the Proposed Transaction results in only one market power screen failure during the Winter Off-Peak season/load period in the Tucson Electric Balancing Authority Area. Specifically, Applicants' analysis shows that, during the Winter Off-Peak season/load period, the HHI increases by 552 points in a moderately concentrated market (the HHI

²³ Application at 12-13.

²⁴ *Id.* at 13.

²⁵ Competitive Analysis Screens are performed using two different measures of capacity, Economic Capacity and Available Economic Capacity. Each supplier's Economic Capacity is the amount of capacity that could compete in the relevant market given market prices, running costs, and transmission availability. Available Economic Capacity is based on the same factors as Economic Capacity but subtracts the supplier's native load obligation from its capacity and adjusts transmission availability accordingly.

value for the market is 1,042).²⁶ Applicants assert that “this small and isolated failure in an off-peak period in an off-peak season should not cause the Commission concern as it is non-systemic and occurs in an off-peak period in an off-peak season [where] market power concerns are reduced.”²⁷ When base case prices are increased by 10 percent,²⁸ the single market power screen failure persists, but the Proposed Transaction passes all seasons/load periods when base case prices are decreased by 10 percent.²⁹

24. Under the Economic Capacity measure, Applicants’ analysis shows that, in the base case scenario, the Proposed Transaction fails the market power screens in eight of the ten seasons/load periods studied in the Tucson Electric Balancing Authority Area.³⁰ Applicants assert, however, that these results should not cause the Commission concern because the Commission has held that the Available Economic Capacity measure is more relevant to assessing the competitive impact of similar transactions where the buyer has significant load obligations.³¹ Since Buyers have such obligations, according to

²⁶ Application, Appendix 2: Affidavit of Matthew E. Arenchild at 7 (Arenchild Aff.). During the Winter Off-Peak season/load period, Buyers’ market share increases from nine percent to 25 percent. *Id.* at 22.

²⁷ Application at 14. Applicants also note that the Proposed Transaction meets the thresholds under the Available Economic Capacity measure in all periods for all six markets first-tier to the Tucson Electric Balancing Authority Area. *Id.*

²⁸ *Id.* at 13. The Commission has explained that every Delivered Price Test should address three scenarios: the base case, in which applicants should use appropriate forecasted market prices to model post-merger competition in the study area, and sensitivity analyses of the base case that measure the effect of increasing or decreasing the market prices relative to the base case. *See, e.g., Duke Energy Corp.*, 136 FERC ¶ 61,245, at P 118, n.278 (2011).

²⁹ Specifically, in the 10 percent price increase scenario, during the Winter Off-Peak season/load period, the HHI increases by 486 points in a moderately concentrated market (the HHI value for the market is 1,103); in the 10 percent price decrease scenario, during the Winter Off-Peak season/load period the HHI increases 365 points in an unconcentrated market (the HHI value for the market is 818). *See* Application, Appendix 2, Affidavit of Matthew E. Arenchild (Arenchild Aff.), Exhibit MEA-3.

³⁰ Application at 14.

³¹ *Id.* (citing *Arizona Pub. Serv. Co.*, 141 FERC ¶ 61,154, at P 58 (2012) (citing *Great Plains Energy Inc.*, 121 FERC ¶ 61,069, at P 34 (2007)), and *Nevada Power Co.*, 113 FERC ¶ 61,265, at P 15 (2005)).

Applicants the market power screen failures under the Economic Capacity measure are not an issue. Applicants note that the Commission has granted FPA section 203 authorizations under similar circumstances.³²

25. According to Applicants, the Proposed Transaction passes all market power screens in the base case and price increase and decrease scenarios when the analysis is based on a 75/25 percent ownership split of Power Block 3 between Tucson Electric and UNS Electric, respectively.³³

26. Applicants responded to the Request for Additional Information by resubmitting their Delivered Price Test with various adjustments, as requested by Commission staff. Applicants assert that the results of the revised studies are not materially different than the results initially submitted with the Application. Applicants note that the Winter Off-Peak season/load period screen failure in the Tucson Electric Balancing Authority Area does not occur in the revised studies, even when prices are increased or decreased by 10 percent.³⁴

ii. Vertical Competition

27. Applicants claim that consolidating Buyers' transmission assets with the Proposed Transaction Assets will not enhance vertical market power because it will not enhance the ability of either company or their affiliates to restrict potential downstream competitors' access to upstream supply.³⁵ Applicants reiterate that access to Buyers' transmission lines is subject to their respective OATTs, and that the assets to be acquired as part of the Proposed Transaction will not enhance their ability to restrict potential downstream competitors' access to upstream supply.

³² *Id.* (citing same cases). Applicants also highlight the Interim Tolling Agreement, noting that, since it conveys control of 200 MW of Power Block 3, the Proposed Transaction would result in a new increase in generating capacity controlled by Buyers of only 355 MW. Applicants state their understanding that, if the terms and conditions of that agreement differ materially from those described in the term sheet included with the Application, an amendment to the Application will be necessary. In addition, Applicants commit to submitting to the Commission the executed Interim Tolling Agreement in this docket within ten days of its execution, following issuance of an order approving the Proposed Transaction. *Id.* at 14-15.

³³ Application, Arenchild Aff. at 24.

³⁴ Applicants Response to Information Request, Supplemental Arenchild Aff. at 8.

³⁵ Application at 16.

28. Applicants note that Buyers are affiliated with UNS Gas, Inc. (UNS Gas), a natural gas utility serving retail customers in portions of northern and southern Arizona. UNS Gas owns 31 miles of intrastate gas transmission and distribution lines that serve the Griffith Power Plant (owned by an unaffiliated third party), the Black Mountain Generating Station (owned by UNS Electric), and the Valencia Generating Facility (owned by UNS Electric). According to Applicants, these limited facilities cannot be used to restrict access to fuel by UNS Gas' affiliates or to otherwise create barriers to entry because UNS Gas is required by Arizona state law to offer retail gas service on a non-discriminatory basis. Applicants conclude that, as a result, Buyers will not have the ability to restrict natural gas deliveries to generating facilities that compete with them.³⁶

b. Commission Determination

29. We find that, based on the corrected Delivered Price Test, the Proposed Transaction, as mitigated during the Interim Period by the Interim Tolling Agreement, will not raise horizontal market power concerns. In response to the Request for Additional Information, Applicants adequately explained their assumptions and corrected the Delivered Price Test submitted with the Application. Specifically, our finding here relies on the results of the Delivered Price Test that incorporates the modifications requested in the Request for Additional Information, as included by Applicants in Exhibit MEA-3 to their response to the Request for Additional Information. The Commission concludes that the changes in HHI that will result from the Proposed Transaction do not exceed the thresholds established in the Competitive Analysis Screen under the Available Economic Capacity measures during any season/load period, even under the price sensitivity scenarios, in the Tucson Electric Balancing Authority Area, the Western Area Power Administration-Lower Colorado Balancing Authority Area, and Applicants' first-tier markets. We note that Applicants appropriately focused on the Available Economic Capacity measure because both Tucson Electric and UNS Electric retain significant load obligations. As Applicants note, the Commission has stated that where applicants retain significant load obligations, it is appropriate to consider Available Economic Capacity as the relevant measure.³⁷

30. While the Proposed Transaction does not result in market power screen failures, the Commission has previously made clear that it will consider evidence of

³⁶ *Id.*

³⁷ See *Great Plains*, 121 FERC ¶ 61,069 at P 34 & n.44; *Westar Energy, Inc.*, 115 FERC ¶ 61,228, at P 72, *reh'g denied*, 117 FERC ¶ 61,011, at P 39 (2006); *Nevada Power Co.*, 113 FERC ¶ 61,265 at P 15.

anticompetitive effects other than increases in HHI.³⁸ We find no evidence of anticompetitive effects that may be masked in the market power screen measures. Also, as Applicants note, in this case there are several factors that reduce any potential incentives to exercise market power, including Buyers' continuing reliance on short-term energy resources following the Proposed Transaction, and a regulatory requirement that requires Buyers to credit profits from wholesale sales to their retail customers.³⁹ The Commission has previously held that factors such as these demonstrate a lack of ability and incentive to exercise market power.⁴⁰ Therefore, we find the Proposed Transaction does not raise horizontal market power concerns.

31. With respect to vertical competition, the Commission has found that combining electric generation assets with inputs to generating power (such as natural gas, transmission, or fuel) can harm competition if a transaction increases the ability or incentive of the parties to exercise vertical market power in wholesale electricity markets.⁴¹ For example, by denying rival firms access to inputs or by raising their input costs, a firm could impede entry of new competitors or inhibit existing competitors' ability to undercut an attempted price increase in the downstream wholesale electricity market.⁴² Here the limited intrastate natural gas facilities owned by UNS Gas do not create the ability for Buyers to exercise market vertical power. Additionally, Buyers' transmission facilities will continue to be subject to a Commission-approved OATT. Based on Applicants' representations, we find that there are no other barriers to entry that would raise vertical market power concerns.

³⁸ *Analysis of Horizontal Market Power under the Federal Power Act*, 138 FERC ¶ 61,109 at P 36.

³⁹ Application, Arenchild Aff. at 5, n.9 ("...both [Buyers] credit all profits from their short-term wholesale sales to their retail customers. ...In this case, [Buyers] are not able to receive any of the benefits of higher prices for their short-term wholesale sales because of their regulatory crediting provisions approved by the [Arizona Corporation Commission].")

⁴⁰ See *Silver Merger Sub, Inc.*, 145 FERC ¶ 61,261, at P 36 (2013); *Arizona Pub. Serv. Co.*, 141 FERC ¶ 61,154, at P 33 (2012).

⁴¹ See *Exelon Corp.*, 138 FERC ¶ 61,167, at P 112 (2012) (*Exelon*).

⁴² *Id.*

2. Effect on Rates

a. Applicants' Analysis

32. Applicants explain that, except for energy exchange agreements and emergency energy sales under the Southwest Reserve Sharing Group Participation Agreement, the contracts under which Buyers' current wholesale electricity customers take service were all entered into under market-based rate authority. As a result, Applicants conclude that the Proposed Transaction will not have an adverse effect on the rates of Buyers' wholesale customers.

33. With respect to Gila River, Applicants note that Gila River only controls Power Block 3, and that all power generated by that block is sold on a spot basis by Gila River at market-based rates, and not to any captive customers. Applicants reiterate that Power Block 4, the only other generation Gila River owns at the Gila River Station, is fully committed to Arizona Public Service Company under a power purchase agreement that has a term extending into 2017. Based on these facts, Applicants conclude that the Proposed Transaction will not have an adverse effect on the rates of Gila River's wholesale customers.

34. Applicants also claim that the Proposed Transaction will not have an adverse effect on Buyers' transmission service rates. Applicants note that Tucson Electric's OATT contains fixed, not formula, rates, and that Tucson Electric is unable to pass through costs related to the Proposed Transaction to its transmission customers absent an application with the Commission pursuant to FPA section 205. Although UNS Electric's OATT contains a formula rate, Applicants assert that any increase in rates resulting from the Proposed Transaction will be "minimal and limited to the effect on the OATT rates of the generation interconnection facilities that comprise part of the [Proposed Transaction Assets]." ⁴³

35. Nevertheless, Buyers "pledge generally to hold harmless all transmission and current wholesale customers from any costs associated with the Transaction (e.g., transaction costs) for a period of five years to the extent that such costs exceed savings related to the Transaction." ⁴⁴ Applicants assert that, consistent with Commission precedent, "transaction costs" in this context includes all transaction-related costs, not

⁴³ *Id.* at 18. Applicants note that Gila River does not own any transmission facilities other than those appurtenant to the Gila River station, so it does not have transmission customers. *Id.*

⁴⁴ *Id.* at 19.

only costs related to consummating the Proposed Transaction.⁴⁵ Applicants explain that the hold harmless commitment “is not a rate freeze and would not preclude changes in jurisdictional rates attributable to non-Transaction costs or to the costs or value of the Transferred Assets themselves.”⁴⁶ Applicants assert that the Commission has accepted similar limitations on hold harmless commitments in previous cases.⁴⁷

b. Commission Determination

36. We agree with Applicants that the Proposed Transaction will not have an adverse effect on rates. First, the Proposed Transaction will not have an adverse effect on wholesale power rates because, except for energy exchange agreements and emergency energy sales under the Southwest Reserve Sharing Group Participation Agreement, Applicants do not make wholesale power sales at cost-based rates, and they will continue to make sales of electric energy pursuant to their market-based rate authorizations.⁴⁸ Further, we note that the Southwest Reserve Sharing Group Participation Agreement provides no mechanism through which the costs of the Proposed Transaction could be passed through to customers and affect those rates.

37. Second, as Tucson Electric’s OATT contains fixed, not formula, rates, there is no mechanism through which Tucson Electric could pass costs associated with the Proposed Transaction on to transmission customers without submitting an application to do so. Further, although UNS Electric’s OATT includes formula rates, the effect of the Proposed Transaction on rates is limited to incorporating the generation interconnection facilities that comprise part of the Proposed Transaction Assets into UNS Electric’s cost of providing transmission service to transmission customers under its OATT.

⁴⁵ *Id.* (citing *ITC Midwest LLC*, 142 FERC ¶ 62,106 (2013) (citing *PPL Corp. & E.ON U.S. LLC*, 133 FERC ¶ 61,083 (2010))).

⁴⁶ *Id.*

⁴⁷ *Id.* (citing *PNM Resources, Inc.*, 110 FERC ¶ 61,204, at P 43 (2005), *Ameren Corp.*, 108 FERC ¶ 61,094, at P 62 (2004), *Tucson Elec. Power Co.*, 103 FERC ¶ 62,100, at 64,163, n.3 (2003)).

⁴⁸ *See Union Electric Co.*, 114 FERC ¶ 61,255, at P 45 (2006) (finding wholesale customers will not be adversely affected where Applicant provides wholesale service at market-based rates); *NorAm Energy Servs., Inc.*, 80 FERC ¶ 61,120, at 61,382-83 (1997) (stating that the Commission’s ratepayer protection concerns do not apply to customers charged market-based rates).

38. We accept Applicants' commitment to hold customers harmless for five years from costs related to the Proposed Transaction. We interpret Applicants' hold harmless commitment to apply to all transaction-related costs, including costs related to consummating the Proposed Transaction and transition costs. Regardless of the terms of Applicants' hold harmless commitment, we remind Applicants that the Commission historically has not permitted rate recovery of acquisition premiums.⁴⁹ If Applicants seek recovery of any acquisition premium associated with the Proposed Transaction, they must be able to demonstrate in a subsequent proceeding under section 205 of the FPA that its acquisition was "prudent and provides measurable, demonstrable benefits to ratepayers."⁵⁰

39. The Commission will be able to monitor Applicants' hold harmless commitment under its authority under section 301(c) of the FPA⁵¹ and the books and records provision of the Public Utility Holding Company Act of 2005.⁵² Moreover, the commitment is fully enforceable based on the Commission's authority under section 203 of the FPA.

40. If Applicants seek to recover transaction-related costs through their transmission rates within five years after the Proposed Transaction is consummated, they must submit a compliance filing that details how they are satisfying the hold harmless requirement. If Applicants seek to recover transaction-related costs in an existing formula rate that allows for such recovery within such five-year period, then that compliance filing must be filed in the section 205 docket in which the formula rate was approved by the Commission, as well as in the instant section 203 docket.⁵³ We also note that, if Applicants seek to recover transaction-related costs in a filing within such five-year period, whereby Applicants are proposing a *new* rate (either a new formula rate or a new stated rate), then that filing must be made in a *new* section 205 docket as well as in the instant section 203

⁴⁹ *Exelon*, 138 FERC ¶ 61,167 at P 118.

⁵⁰ *ITC Holdings Corp.*, 139 FERC ¶ 61,112 at P 50 & n.116 (2012) (citing *Minnesota Power & Light Co.*, 43 FERC ¶ 61,104, at 61,342, *reh'g denied*, 43 FERC ¶ 61,502 (1988); *Duke Energy Moss Landing, LLC*, 83 FERC ¶ 61,318, at 62,304 (1998); *PSEG Power Connecticut, LLC*, 110 FERC ¶ 61,020, at P 32 (2005)).

⁵¹ 16 U.S.C. § 825(c) (2012).

⁵² 42 U.S.C. § 16452 (2012).

⁵³ In this case, the filing would be a compliance filing in both the section 203 and 205 dockets.

docket.⁵⁴ The Commission will notice such filings for public comment. In such filings, Applicants must: (1) specifically identify the transaction-related costs they are seeking to recover, and (2) demonstrate that those costs are exceeded by the savings produced by the transaction, in addition to any requirements associated with filings made under section 205. Such a hold harmless commitment will protect customers' wholesale and transmission rates from being adversely affected by the Proposed Transaction.⁵⁵ Finally, we note that no customer has argued that consummation of the Proposed Transaction would have an adverse effect on rates.⁵⁶

3. Effect on Regulation

a. Applicants' Analysis

41. Applicants assert that the Proposed Transaction will not diminish federal regulatory authority over Tucson Electric, UNS Electric, or Power Block 3 of the Gila River Station. According to Applicants, following consummation of the Proposed Transaction, Buyers, and their jurisdictional assets and wholesale power sales from Power Block 3, will remain subject to the Commission's jurisdiction under the Federal Power Act. Applicants also explain that the Proposed Transaction will not have adverse effect on state regulation since Arizona Corporation Commission approval will be required prior to Buyers including Power Block 3 in rate base.

b. Commission Determination

42. We find no evidence that either state or federal regulation will be impaired by the Proposed Transaction. The Commission's review of a transaction's effect on regulation focuses on ensuring that it does not result in a regulatory gap at the federal or state level.⁵⁷ We find that the Proposed Transaction will not create a regulatory gap at the federal level because the Commission will retain its regulatory authority over Buyers and

⁵⁴ In this case, the filing would be a compliance filing in the section 203 docket, but a rate application in the section 205 docket.

⁵⁵ See *ITC Midwest LLC*, 133 FERC ¶ 61,169, at PP 24-25; *FirstEnergy Co.*, 133 FERC ¶ 61,222, at P 63; and *PPL Corp., et al.*, 133 FERC ¶ 61,083, at PP 26-27 (2010).

⁵⁶ Applicants state that Gila River does not own any transmission facilities other than those appurtenant to the Gila River Station, and does not have transmission customers. Application at 18.

⁵⁷ Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,124.

Power Block 3 after the Proposed Transaction is consummated. As to the state level, the Commission explained in the Merger Policy Statement that it ordinarily will not set the issue of the effect of a transaction on state regulatory authority for a trial-type hearing where a state has authority to act on the transaction. However, if the state lacks this authority and raises concerns about the effect on regulation, the Commission may set the issue for hearing and it will address such circumstances on a case-by-case basis.⁵⁸ Applicants represent that the Arizona Corporation Commission will review the inclusion of Power Block 3 in Tucson Electric's or UNS Electric's rate base; further, no state has raised any concerns regarding the effect of the Proposed Transaction on regulation.

4. Cross-Subsidization

a. Applicants' Analysis

43. Applicants state that, based on the facts and circumstances known to them or that are reasonably foreseeable, the Proposed Transactions will not result in, at the time of the Proposed Transaction or in the future, cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company.⁵⁹ In support of this claim, Applicants state that:

(1) Buyers' utility assets are not pledged or encumbered except as through general bond issuances such as those routinely used by utilities to raise capital.

(2) the Proposed Transaction will not result in any transfers of facilities between a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, and an associate company;

(3) Buyers may, in order to effectuate the Proposed Transaction, issue new debt, but such issuance will not benefit any associate company and, therefore, will not result in any new issuance of securities by a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company;

(4) Buyers may, in order to effectuate the Proposed Transaction, issue new debt, but such issuance will not benefit any associate company and, therefore, will not result in any new pledge or encumbrance of assets of a traditional public utility

⁵⁸ *Id.* at 30,125.

⁵⁹ Application, Exhibit M: Cross-Subsidization, Pledges or Encumbrances of Utility Assets.

associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company and

(5) the Proposed Transaction will not result in any new affiliate contract between a non-utility associate company and a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, other than non-power goods and services agreements subject to review pursuant to FPA sections 205 and 206.⁶⁰

b. Commission Determination

44. Based on the representations in the Application, we find that the Proposed Transaction will not result in an inappropriate cross-subsidization or the pledge or encumbrance of utility assets for the benefit of an associate company. We note that no party has argued otherwise.

C. Accounting

45. Appendix 3 of the application includes proposed accounting entries, without disclosing amounts, recording Tucson Electric's and UNS Electric's joint acquisition of the Proposed Transaction Assets.⁶¹ Tucson Electric and UNS Electric propose to clear the acquisition through Account 102, Electric Plant Purchased or Sold, and record the original cost of the Proposed Transaction Assets and related accumulated depreciation on their books. They anticipate a negative acquisition adjustment resulting from the acquisition and propose to record the amount as a credit to Account 108, Accumulated Provision for Depreciation of Electric Utility Plant. Also, Tucson Electric and UNS Electric propose to record legal costs in Account 102 and treat these costs as part of the purchase price of the Proposed Transaction Assets.

46. The proposed recording of the Proposed Transaction Assets on the Buyers' books at depreciated original cost is consistent with the Commission's Uniform System of Accounts.⁶² Also, the Commission has held that negative acquisition adjustments should

⁶⁰ 16 U.S.C. § 824e (2012).

⁶¹ Tucson Electric and UNS Electric represent that they require additional time to determine the appropriate amounts associated with the transaction and that they will submit final accounting entries to the Commission within six months of closing of the Transaction.

⁶² Electric Plant Instruction (EPI) No. 5, Electric Plant Purchased or Sold, and Instructions to Account 102, Electric Plant Purchased or Sold, 18 C.F.R. Part 101 (2014).

be cleared to Account 108.⁶³ Tucson Electric and UNS Electric must submit their final accounting entries in accordance with EPI No. 5 and Account 102 within six months of the date that the Proposed Transaction is consummated, and the accounting submissions must provide all the accounting entries and amounts related to the purchase along with narrative explanations describing the basis for the entries.

D. Other Considerations

47. Order No. 652 requires that sellers with market-based rate authority timely report to the Commission any change in status that would reflect a departure from the characteristics the Commission relied upon in granting market-based rate authority.⁶⁴ To the extent that the foregoing authorization results in a change in status, Applicants are advised that they must comply with the requirements of Order No. 652. In addition, Applicants shall make any appropriate filings under section 205 of the FPA to implement the Proposed Transaction.

48. Information and/or systems connected to the bulk power system involved in the Proposed Transaction may be subject to reliability and cyber security standards approved by the Commission pursuant to FPA section 215.⁶⁵ Compliance with these standards is mandatory and enforceable regardless of the physical location of the affiliates or investors, information databases, and operating systems. If affiliates, personnel, or investors are not authorized for access to such information and/or systems connected to the bulk power system, a public utility is obligated to take the appropriate measures to deny access to this information and/or the equipment/software connected to the bulk power system. The mechanisms that deny access to information, procedures, software, equipment, etc., must comply with all applicable reliability and cyber security standards. The Commission, NERC or the relevant Regional Entity may audit compliance with reliability and cyber security standards.

⁶³ See, e.g., *Southwestern Public Service Company and New Mexico Electric Service Company*, 23 FERC ¶ 61,153 (1983).

⁶⁴ *Reporting Requirement for Changes in Status for Public Utilities with Market-Based Rate Authority*, Order No. 652, FERC Stats. & Regs. ¶ 31,175, *order on reh'g*, 111 FERC ¶ 61,413 (2005). See 18 C.F.R. § 35.42 (2014).

⁶⁵ 16 U.S.C. § 824o (2012).

The Commission orders:

(A) The Proposed Transaction is hereby authorized, as discussed in the body of this order.

(B) Applicants must inform the Commission within 30 days of any material change in circumstances that departs from the facts the Commission relied upon in authorizing the Proposed Transaction.

(C) The foregoing authorization is without prejudice to the authority of the Commission or any other regulatory body with respect to rates, service, accounts, valuation, estimates or determinations of costs, or any other matter whatsoever now pending or which may come before the Commission.

(D) Nothing in this order shall be construed to imply acquiescence in any estimate or determination of cost or any valuation of property claimed or asserted.

(E) The Commission retains authority under sections 203(b) and 309 of the FPA to issue supplemental orders as appropriate.

(F) Applicants, to the extent that they have not already done so, shall make any appropriate filings under section 205 of the FPA, as necessary, to implement the Proposed Transaction.

(G) Tucson Electric and UNS Electric shall account for the Proposed Transaction in accordance with Electric Plant Instruction No. 5 and Account 102, Electric Plant Purchased or Sold, of the Uniform System of Accounts. Buyers shall submit its final accounting entries within six months of the date that the Proposed Transaction is consummated, and the accounting submissions shall provide all the accounting entries and amounts related to the transfer along with narrative explanations describing the basis for the entries.

(H) Applicants shall notify the Commission within 10 days of the date on which the Proposed Transaction is consummated with the final percentage ownership of each of the Buyers.

(I) Applicants shall submit in this docket the executed Interim Tolling Agreement within 10 days of its execution.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.